

BEFORE THE INTERSTATE COMMERCE COMMISSION

**Revenues of Rail Carriers in Official
Classification Territory**

on Petition for Modification of Order

**Argument of Moritz Rosenthal
for**

Investment Bankers Association of America

MR. CHAIRMAN AND GENTLEMEN OF THE COMMISSION:

I appear here, on behalf of and as one of the Investment Bankers of the United States and wholly independent of those representing the railroads in the territory affected, ask that the bankers be briefly heard upon the pending application. I shall undertake to demonstrate the justification for that appearance by pointing out to you:

FIRST—That it appears from your opinion that the total capital obligations of the 112 railroads involved in this application outstanding in the hands of the public in 1913 amounted to \$6,389,535,638; that their gross operating revenues for that year were \$1,424,119,991; that “great mining and manufacturing enterprises and other widely diversified industries are located” in the territory covered by these roads, “a large proportion of our population resides there and the routes over which flows the vast commerce interchanged between the Atlantic Seaboard and the Mississippi Valley pass through it. The carriers in that territory move more than half the tonnage of the entire country.” The total capital obligations of all the railroads of the United States outstanding in the hands of the public are over \$15,000,000,000 of which about \$10,000,000,000 are bonds.

SECONDLY—It appears from the contention made by the railroads that unless the rates are increased “their credit will suffer so that they will be unable to secure additional capital required for extending their lines and for enlarging their facilities in order to meet the present and future needs of shippers; and that it will be impossible to pay to the present owners of these properties a fair return upon their investment. They also assert their need of increased revenues is urgent.” If this is a logical reason for an increase of rates, then it follows that we should be heard, because it is we that extend the credit and secure and furnish the capital. That leads me directly to the question—Who are the Investment Bankers of America?

It appears from the hearing what the composition of the Association is, its ramifications in the financial world, not only in this country, but in Europe, from all of which it appears, among other things, that the Investment Bankers Association of America comprises in its membership practically all of the responsible dealers in corporate securities doing business in the United States; that the investment banker is not a broker but that he is a security merchant who buys bonds and shares at wholesale and retails them to his clients, and that it is through the investment banker that a large proportion of the savings of this nation and, prior to the outbreak of the war, a substantial portion of the savings of Europe have been converted into productive enterprise. It is the function of the banker to exchange securities for surplus funds in the hands of his client and thus to put idle capital to a beneficial use.

While the majority opinion does not say so in terms, I get the impression that the Commission has indicated that, it being an administrative body with quasi judicial functions but no legislative power, it was not as a body concerned with the promotion of the general public welfare. If I am right in my interpretation of the opinion in this regard, I respectfully take issue with such a position. It seems to me that the history of the Interstate Commerce Act and its evolution into its present form all cry out against the imposition of such limitations upon your powers. And I submit the proposition that in fixing rates may not the Commission take into consideration factors other than (a) the railroads and (b) the shippers and receivers of the freight? Is there not a broader aspect which you have the right and which it may be your duty to recognize, namely, the interest and welfare of the public as a whole, because the whole public is at least tendentially affected by the matter of railroad rates? In a hearing such as this, is there not something more involved than (a) the right of the public to the best service at a proper rate *per se* and (b) the right of the railroad investors to a fair return on their investment? Personally I am likewise impressed with the thought that there are also involved the rights of all investors other than railroad investors, because the whole financial structure of the country is so interwoven with railroad securities that to affect railroad securities adversely is to injure and imperil the whole struc-

ture. This we have developed fully on the hearing, and if satisfactorily developed it is again an adequate justification for our being heard.

We understand that the railroad companies have not predicated their petition for a re-hearing primarily upon the world-wide crisis that now exists because of the European war. Neither do we propose to rest our case wholly upon that, but we believe that, aside from all of the other considerations which we propose calling to your attention, the crisis produced by the war is alone amply sufficient to justify the granting of the rate increase and that the war alone has made imperative the need for immediate relief, and therefore the situation does not permit, as suggested by the Commission in its main opinion, "the orderly investigation of the possible sources of additional revenue other than by the proposed freight rate increase."

There is no question in the minds of the dealers in railway securities that the European conflict has produced such a crisis. Evidence to this effect is no longer necessary to convince us, for every dealer realizes that the conditions which inevitably produce a crisis are now confronting us on all sides. The enormous destruction of wealth now taking place, greater probably than at any other time in the history of the world, the tremendous indirect economic losses as the result thereof, owing in part to the present highly developed uses of international credits, are causes all of which combine to greatly increase interest rates and add additional burdens to seekers for capital.

The stock exchanges of the world have been generally closed since July 29th. Public policy necessitated their closing and thus far has prevented their opening. Despite the absence of these ordinary means of selling securities and the temporary curtailment of sales by belligerent countries, as well as the arbitrary fixing of prices by various stock exchange committees, it is impossible to sell small amounts of securities forced for sale by actual necessity without a considerable decline. In the meantime hundreds of millions of capital is being destroyed. Although various moratoria are temporarily postponing the necessity for forced selling of securities to liquidate loans and settle debts, yet it is certain that the positive needs of European investors cannot be much

longer delayed. Europe's holding of railroad securities, estimated at more than \$3,000,000,000, therefore is an immediate factor in the present railroad situation, and the menace of European sales of railroad securities is a vital consideration in the present credit crisis of our railroad industry. All this is reflected in the greatly reduced buying demand and especially in the decided discrimination shown against railroad issues. For example, the \$100,000,000, of New York City Notes, the largest amount ever offered at any one time, were heavily oversubscribed on a 6% basis and are now selling on a $5\frac{1}{4}$ to $5\frac{3}{4}$ % basis, while the six months and one year notes of the New York Central are being poorly taken by investors although offered on a $6\frac{1}{2}$ % basis. The almost inevitable flood of European sales of railroad securities may perhaps, to some extent, be stemmed by an immediate and radical increase in rates, so as to give notice to the world that the crisis is recognized here and that every governmental agency proposes to do its utmost towards sustaining American credit and preventing a breakdown in American securities, and this, I may be permitted to remind you, is in line with the splendid work already done by the Executive Department of the Government to meet the existing crisis.

Not only must we anticipate such European sales; we must also recognize the decreased buying power of American investors: First—because of the investor's attitude toward railroad securities and his lack of confidence in the credit position of our railroads—a subject matter that will be fully developed hereafter—and, Secondly, because of the decrease in the actual buying power, not only of European nations, but of our own people, arising from business losses, as evidenced, for example, by the loss of our Southern cotton business and by the enormous losses which importers and exporters in many lines of enterprise are meeting with.

But the investor's attitude toward railroad securities is not alone due to the acute crisis growing out of the war. It is founded upon other far-reaching causes that have been cumulating and growing for more than a decade. I hold no brief for the railroads in this cause and in common with every honest banker in the country, denounce dishonest railroad management and corrupt railroad financial jugglery. Yet railroads are human institutions, run by human beings subject to all the frailties of mankind, and it will not do to undertake to base a

decision in this cause upon that which we should have in an ideal state. Theoretically it may be true, as the Commission has said in its majority opinion, that "those who invest their funds in railroad shares are, of course, charged with the responsibility of securing for their properties honest and capable managements;" that "investors in railroad securities, like investors in other securities, must bear the consequences of dishonesty or inefficiency on the part of those selected to manage the properties." Theoretically, I say, this is true. As a matter of fact, however, to effect a change in a railroad management by action of the security holders themselves is an exceedingly difficult thing to accomplish. The very fact that the securities are frequently held in small parcels by people living hundreds of miles from each other, without any opportunity for unity of action, and with the individual holding so small as to make it financially fruitless, all add to the difficulty of changing railroad corporate management at times when perhaps the change should be made. After all, with the increase in the exercise of governmental supervision, with the wide powers given to the Commission to act both as investigator, prosecutor and court, may it not be said that it is as much the duty of this Commission to detect and depose dishonest and incompetent railroad management as that of the individual stockholder or group of stockholders who have imposed upon them scores of limitations that make it almost impossible for them to act for themselves?

But after all is said that can be on this subject, it remains true, as stated in the majority opinion, that "we may justly feel proud of the development of our transportation system. Despite occasional discreditable chapters the history of our railroads has been marked by great achievements."

Nor do we propose to discuss at any length what appears to be the steadily decreasing percentage of net earnings to gross earnings of the railroads, because that subject, as I understand, was exhaustively gone into by all parties on the original hearing. We may be permitted, however, to show that because of this steadily decreasing percentage the present railroad situation constitutes a crisis and, partially at least because of a constantly growing realization on the part of merchants in railway securities and their customers, the investors, that the earning power of a trans-

portation system does not expand and contract freely with the expansion and contraction of business, as in the case of industrial corporations, but is subject to various forms of governmental regulation that apparently thus far have proven too inelastic to satisfactorily safeguard capital.

I am assured by some of the best bond men in the country that many, if not most of their clients, now have the settled conviction that Government—both Federal and State—is antagonistic to the railway systems.

I am sufficiently familiar with the progress of recent events to understand the evils which the courts and the several Federal and State Commissions were originally called upon and were created to reduce or suppress; and it is hardly necessary to say that the public, which has to assume the losses occasioned by corporate mismanagement or fraud, has been fully apprised of the cause of their misfortune.

I do not assert or propose to discuss the question as to whether such antagonism actually exists. The real question is—does the investor *believe* that governmental bodies are antagonistic to railroads? To the extent and during the time that the belief exists, railroad credit must pay the penalty. Nor is this belief confined alone to America. We have the best of evidence that Europe feels as strongly, and Europe's belief is harder to override than ours, for it is not subject to the prompt modification that may come with the full knowledge of current conditions as they may change from time to time.

There is a real basis for this belief in Government antagonism. There has been for some years past a virulence of utterance in legislative halls and perhaps in other quarters, a willingness to criticise indiscriminately, to impute motives without evidence, to assume guilt as charged, and to condemn without trial, that, to say the least, certainly evidences hostility. I do not think that this is a harsh criticism, particularly in view of the fact that the Government has failed in practically every one, if not all of its great criminal prosecutions instituted under the anti-trust acts since 1905. Many laws are enacted which, if not born in hostility, have been passed in indifference to railroad welfare. Suits to dissolve consolidations and

congressional investigations, however justifiable in some instances, have all contributed with increasing frequency to the sentiment now so general, that Government is against the railways. No group of men is in such good position as the Investment Bankers to appraise this sentiment and its probable effect, for they are in touch with all those whose attitude affects credit—the investors.

Cumulative evidence of this nature already has led many to the belief that the logical outcome is Government ownership, accomplished by the reduction of weak properties to insolvency and a low purchase price. Not uncommonly we meet the phrase: "American railroads are headed toward bankruptcy." The life insurance companies of the State of New York have invested in railroad securities approximately \$1,400,000,000. During the past year three of the greatest life insurance companies of that State have refused to make any additional investments in railroad securities; not because, I am advised, of a depreciation in the market value of such securities, but because of their apprehension of the future of railroads in this country. I am also advised that to some extent the same situation is true in connection with the trust companies and savings banks of the country. The real fact, of course, is that the greatest and most important purchasers of railroad securities in the past have been the life insurance companies, trust companies and savings banks. Their practical withdrawal from the market in itself is an ominous indication of the ability of the railroads to finance in the future as they have in the past.

The immediate result of all this is, of course, weakened credit, because credit, after all, is but the result of the judgment of the lenders as to what the borrowers will be able to pay. To practical bankers the immediate thing is not whether this Commission believes that railroad earnings are sufficient to show a proper margin of safety over charges, but whether security purchasers think so; and that, I contend, is a proper factor for the Commission to take into consideration. Credit cannot be furnished by deciding that the borrower should be able to obtain it. The ultimate test is the willingness of the public to supply the amount of capital which the railroads must have and without which financial calamity will inevitably result.

I do not say that the increase in railroad rates now asked for *as a single step* will of itself sufficiently increase the willingness of the public to furnish the necessary capital, but we feel satisfied that the refusal of the Commission to grant the advance at this time will make it impossible to prevent this calamity. The supply of capital is bound to be affected by the attitude of the Government and the various States towards the railroads, as well as by the earnings which the railroads report, because many of our people have come to believe that the attitude represents a cause of which decreasing earnings are the result.

Whether the five per cent. increase asked for will produce an amount adequate to accomplish the desired end is perhaps doubtful. But it will help. It is certain, however, that practice of economy and efforts towards efficiency are not adequate immediate sources of income. Whatever else may be done, the main immediate recourse must be an increase in the price of transportation.

For the safeguarding of investors and for the welfare of the railroad industry of the country we urge that the Commission render promptly the aid within its power by granting in full this present petition, mindful of the words of our great President, that "we must all stand as one to see justice done and all fair assistance rendered and rendered ungrudgingly."